

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Robert Scannell, May 3, 2006

DATED: May 11, 2006

On Wednesday, May 3, 2006, Sharon Blaskey and Jesenia Ruiz de la Torre, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Robert Scannell. Mr. Scannell was represented by counsel, Michael Branch. Also in attendance was Donielle Evans of KPMG. The interview took place in a conference room on the 3rd floor of the City Administration Building, 202 C Street in San Diego, and lasted approximately three hours.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Robert Scannell, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Ms. Blaskey began the interview by explaining the circumstances and purpose of the City of San Diego's (the "City") creation of the Audit Committee, noting that information obtained during the course of the interview would be used, if relevant, in the Audit Committee's eventual report. Ms. Blaskey explained that Willkie does not represent Mr. Scannell and, thus, statements made during the interview are not covered by the attorney-client privilege. Nonetheless, we would be treating the information obtained during the interview as confidential, covered by the work-product privilege during the investigation, but any such privilege would likely be lost with the release of the Audit Committee's report. Ms. Blaskey asked that Mr. Scannell keep the interview confidential. Ms. Blaskey further explained that, if requested, we would provide information from the interview to the SEC, the U.S. Attorney's Office or the City's outside auditor, KPMG, so it is important that Mr. Scannell be accurate and truthful. Ms. Blaskey emphasized that Mr. Scannell should seek clarification of any question at any time. Approximately halfway through the interview there were also discussions regarding the attorney-client privilege. Ms. Blaskey cautioned Mr. Scannell not to divulge the substance of the information that he discussed with his counsel. Mr. Scannell and his counsel stepped out of the room to discuss the privilege further and then the interview resumed.

Background

Mr. Scannell explained that in either 1992 or 1993, he wanted to serve the public in some way. Mr. Scannell considered running for public office, but when he saw that there was an opening on the SDCERS Board he chose to run in 1993. Mr. Scannell ran once and was not

elected, but he ran again the following month when a new position opened, and he won the requisite number of votes from the City Council and the Mayor. Mr. Scannell explained that SDCERS Board member's term is six years. However, if a Board member chooses to resign prior to the expiration of his term, the new candidate's term would only be as long as the remainder of the prior member's term. Mr. Scannell stated that not being appointed to the Board after his first attempt worked to his advantage, because that term was only for a few months, whereas the term he was appointed to after his second attempt was a full six year term. After his first term expired, Mr. Scannell was unanimously reappointed and stayed on the Board until 1999. When SDCERS President Keith Enerson left the Board, several Board members suggested that Mr. Scannell run for President. Mr. Scannell recalled that he decided to run, but before he asked any other Board members for support, he discovered that Diann Shipione was also running. Mr. Scannell recalled that the Board voted by secret ballot, and he won the election. Ms. Shipione challenged the vote, stating that it should have been an open election, rather than by secret ballot. Another vote was taken, and Mr. Scannell also won that vote. Ms. Blaskey asked Mr. Scannell to express his impressions of Ms. Shipione, including with regard to her level of competency, but on the advice of counsel, Mr. Scannell declined to answer. Mr. Scannell chose to join the Board because he had thought that it was a good fit for him. Mr. Scannell stated that as a stockbroker and consultant, he became knowledgeable regarding financial markets; he also has a Series 7 Certification. When Ms. Blaskey asked Mr. Scannell how he learned about the existence of the Board, he replied that he had always known a retirement board existed.

SDCERS Board General Information

Mr. Scannell recalled that the Board included four "at large" or independent members who were appointed by the City Council. The Board was also composed of nine City employees. Mr. Scannell noted that several archaic laws existed regarding the composition of the Board, but they were not followed. An example he gave was a law that required a head of a local bank to serve on the Board.

Prior to joining the SDCERS Board, Mr. Scannell had no experience with pension or retirement issues. Nevertheless, he stated that he knew what a funding ratio was and that an actuary determined what funds needed to be contributed to the system. Mr. Scannell could not recall receiving any training after joining the SDCERS Board. Mr. Scannell stated that he may have received a brochure regarding the fiduciary duties of Board members, but that most of his learning was "through osmosis."

Mr. Scannell described his understanding of actuarial reports. He stated that he would generally read the documents that were given to him, including the actuarial reports, but that he would not read them word for word. Mr. Scannell believed "he got the gist" of the funding ratio; he would describe his level of retirement knowledge as average. He believed that the main issue within SDCERS was the funding ratio, because it demonstrated whether at any given time SDCERS could discharge its current liabilities. Mr. Scannell said that, for example, if the funding ratio was 90% that meant that even if SDCERS never received any additional contributions, SDCERS would currently be able to satisfy all of its debt except for 10%. Mr. Scannell explained that "actuarial soundness" was an indicator of the health of the system.

The role of SDCERS Board members, SDCERS staff, the City, and the actuary were also discussed. Mr. Scannell felt that the Board owed fiduciary duties to the system's beneficiaries and that the Board also had a duty to maintain the systems assets. He said the relationship between the two was symbiotic because he believed he had an obligation to protect the individual beneficiaries, while at the same time he had an obligation to enrich and protect the fund's assets. He believed that the Board needed to "protect the working man's money." Mr. Scannell did not believe that it was the Board's responsibility to establish the benefits that would be available to retirees. Mr. Scannell thought that the Board's duty was to administer the funds, while the City, through the meet and confer process, decided what benefits would be available to retirees. Mr. Scannell stated that he thought that the actuary should analyze all of the relevant data and then come to the Board with the amount that the City needed to contribute. He also stated that he relied on the actuary to "make these tough calls." Mr. Scannell recalled that the role of SDCERS staff was to assist retirees with the benefits application process by educating them, to send out checks, and to generally to keep the system going. Mr. Scannell stated that he had spoken to Lawrence Grissom once or twice a month regarding administrative issues, such as the date of the next Board meeting.

Mr. Scannell reviewed an opinion letter executed by Morrison & Foerster, dated August 22, 1995 (Exhibit 1). Mr. Scannell stated that the name Morrison & Foerster "rang a bell." He did not recall the letter or the issues addressed in it. Ms. Blaskey asked Mr. Scannell whether a document such as this, addressed to Lawrence Grissom, would be forwarded to the Board. Mr. Scannell replied that he could not recall whether or not he generally would receive documents from Mr. Grissom.

Moving on to the next subject, Ms. Blaskey asked Mr. Scannell to discuss how Board meetings would typically progress. Mr. Scannell replied that the Board would receive an agenda a week or two in advance of a meeting in the mail. The agenda would include a list of individuals who were coming up for retirement as well as old and new business to be discussed by various Committees. Mr. Scannell recalled thinking that he could call SDCERS staff if he had any questions regarding the agenda, but he would rarely make those types of calls. Mr. Scannell stated that typically a meeting was called to order and the first item of business was to discuss the benefits that newly retired individuals would receive. During that portion of the meeting, new retirees would be present to answer any questions that the Board had, but Mr. Scannell could not recall any questions ever being asked of those individuals. Next, committees would make recommendations and the full Board would vote. Minutes were prepared for all of the Board meetings. Those minutes would be reviewed by the Board and sometimes corrections would be made, but that was rare. Mr. Scannell recalled that anyone could submit a proposal, which would then be discussed at a Board meeting. Getting items on the agenda usually required approaching a committee first. If an item was not on the meeting's agenda it could be discussed at the end of the meeting, but Mr. Scannell never recalled that occurring.

Mr. Scannell also briefly discussed the Business and Procedures Committee and the Investment Committee. The Business and Procedures Committee handled the "nuts and bolts" of retirements and disabilities. The Business and Procedures Committee would apply a formula to determine the benefits an individual would receive. Mr. Scannell recalled assuming that when the Board voted on the benefits to be distributed, the Committee had already gone through that formula. Mr. Scannell also noted that the actuary, Rick Roeder, would present

actuarial reports to the Business and Procedures Committee on a yearly or quarterly basis. Mr. Scannell recalled that he was a member of the Investment Committee throughout his tenure on the Board; he was also the Committee Chairman after being a Board member for three or four years. The Investment Committee's purpose was to ensure that the system's assets were properly allocated among investments. To that end, the types of investments that should be made were discussed and the Committee worked with investment advisors. Doug McCalla was one such advisor. During his tenure on the Investment Committee, Mr. Scannell recalled that McCalla informed him that SDCERS was in the top 10% regarding investment performance when compared to other public funds.

Manager's Proposal One

Mr. Scannell recalled that he learned about MP-1 either at a Board meeting or through documents that were given to him. He also recalls that a presentation regarding MP-1 was given to the Board prior to the Board approving it. When he first learned about MP-1, Mr. Scannell wanted more details and he wanted to be sure that SDCERS would be protected.

Mr. Scannell recalled that the SDCERS Board meeting where MP-1 was approved was held in City Council's chambers, because it was anticipated that additional individuals would be in attendance. (He could not recall whether more individuals than usual did attend). It seemed to Mr. Scannell that MP-1 was a "big deal." Mr. Scannell could not recall if Jack McGrory was present when MP-1 was approved, and while he recalled that Mr. McGrory was involved with MP-1, he could not recall the extent of that involvement. Mr. Scannell recalled that an individual from Mr. McGrory's office left him a voicemail asking him to consider MP-1 and stating that they hoped that he would support the proposal. He could not recall who specifically called him, and said it might have been Mr. McGrory himself.

Mr. Scannell stated that when MP-1 was approved, SDCERS was very well funded and the City was having difficulties making their employer contributions. Additionally, Mr. Scannell expressed his belief that it was important "to get the working man the best deal he could get," and that if benefits were increased, then how could he not approve that proposal as a fiduciary of the beneficiaries. Ms. Blaskey asked Mr. Scannell whether he thought that MP-1 in being tied to benefit increases, created a conflict with Ms. Scannell's duty to protect the assets of the system. Mr. Scannell replied that he did not think so, but that he really did not know how to answer that question. Mr. Scannell recalled that he thought MP-1 was a safe deal regarding the assets and the participants, because SDCERS was very well funded at a ratio of approximately 90%. Mr. Scannell stated that even if the funding ratio dropped to the amount of the trigger, which Mr. Scannell recalled being approximately 80%, that would still be a healthy ratio for the system. Mr. Scannell could not recall what the City would be obligated to contribute to the system if the trigger was hit, but he stated that it was clear that the funding ratio would go down after MP-1 was approved. Mr. Scannell felt that this was a cost to SDCERS, but there would also be increased benefits for the system's beneficiaries. That being the case, he viewed MP-1 as a "solid deal." Mr. Scannell stated that he felt that way then and he is fairly certain that he would feel likewise today. Mr. Scannell does not recall any debates regarding the propriety of MP-1 after it was approved.

After reviewing the June 21, 1996 SDCERS Board Minutes, in which MP-1 was approved (Exhibit 2), Ms. Blaskey asked Mr. Scannell to describe his understanding of the

proposal that was presented to the Board on June 21, 1996. Mr. Scannell replied that, speaking generally, there would be increased benefits for the system's beneficiaries, the City would forego some of its contributions to the system, and there would be a safety net. Ms. Blaskey then asked Mr. Scannell questions regarding some of the specific benefits that would be granted through MP-1. Mr. Scannell stated that he could recall that Purchase Service Credits had to do with the consequences of an employee leaving their job and then returning to it, but that benefit did not stand out to him as an element of MP-1. Shifting the burden of paying for healthcare costs did not sound familiar to him. Mr. Scannell recalled that while he was familiar with the 13th check, he was not aware of that being a component of MP-1. Mr. Scannell recalled that "GASB" is an accounting term, but that he did not know if MP-1 would comply with GASB. Mr. Scannell also reviewed the Concept Overview of MP-1, dated May 2, 1996 (Exhibit 3). After reviewing that document, Mr. Scannell stated that he did not recall MP-1 initiating the Deferred Retirement Option Plan ("DROP"), but he was familiar with the acronym "D.R.O.P." The purpose of that program, according to Mr. Scannell, was to allow employees who could retire to continue working in exchange for the receipt of their salaries and other benefits. Mr. Scannell thought that DROP was beneficial, because then the City could continue to employ experienced personnel and the City could avoid hiring new employees who would be entitled to increased benefits. Thus, in Mr. Scannell's opinion DROP resulted in "savings to the City." Mr. Scannell could not recall if DROP also resulted in savings to SDCERS.

After reviewing the June 21, 1996 SDCERS Board Minutes (Exhibit 2), Mr. Scannell also recalled that John Casey (a fellow SDCERS Board member) addressed the Board. Mr. Scannell could not recall what was said and seeing a memorandum authored by Mr. Casey (Exhibit 4), in which he expressed concerns about the propriety of MP-1, did not refresh his recollection as to what was said. Mr. Scannell recalled that after addressing the Board, Mr. Casey "symbolically" walked out of the meeting.

Mr. Scannell was also shown several documents, the information below summarizes the discussions that were had after those documents were reviewed:

- Mr. Scannell was shown a memorandum from Jack McGrory to the SDCERS Board via Larry Grissom, dated February 17, 1994 (Exhibit 5). Mr. Scannell did not recall ever seeing the memorandum. The memorandum's last paragraph stated that Mr. McGrory was confident that an agreement could be reached that enabled the Board to maintain its fiduciary duties and allowed the City to reduce its contributions. Ms. Blaskey asked whether Mr. Scannell could recall efforts to reduce the City's contribution to the fund as early as February 1994. Mr. Scannell stated that he could not specifically recall that, but that he recalled discussions in the mid-1990's regarding SDCERS funding ratio being high and the City asking the system if they could decrease their contributions or delay the time that they would become due. Mr. Scannell could not recall the exact circumstances under which he learned this information; it could have been at a Board meeting or in the newspaper.
- Mr. Scannell reviewed the February 24, 1995 SDCERS Board Minutes, which included a discussion by the Corridor Concept Subcommittee at page six (Exhibit 6). Mr. Scannell stated that he is not familiar with the term "corridor funding," but he may have been in the past. He also could not recall what either PUC or EAN meant.

Mr. Scannell also did not understand what Rick Roeder was referring to in the minutes when Mr. Roeder stated that if the City obtained rate relief, outside counsel could insist that there be some sort of a trade off (page 9).

- Mr. Scannell was shown a memorandum from Lawrence Grissom, dated March 16, 1995 (Exhibit 7), regarding the Corridor Concept Subcommittee's recommendations. Mr. Scannell could not recall anything about that document.
- Mr. Scannell was shown the March 24, 1995 SDCERS Board Minutes, which discuss corridor funding and the "earnings stabilization reserve." He could not recall what those terms meant (Exhibit 8). The Minutes reflect at page 4 that Mr. Scannell objected to the use of the "earnings stabilization reserve." Mr. Scannell could not recall this. Mr. Scannell also stated that he did not recall ever talking to outside fiduciary counsel outside of a Board meeting or ever seeing a presentation by fiduciary counsel.
- Exhibit 9 is a memorandum from Bruce Herring, dated February 12, 1996, regarding Herring's request that the City Attorney review Morrison & Foerster's opinion letter related to bifurcated rates. After receiving that memorandum, Mr. Scannell recalled that Joseph Wyatt, of Morrison & Foerster, attended several Board meetings, but that after 1996 he was no longer retained. Mr. Scannell could not recall why that had happened, but he stated that he did not get the impression that the Board was opinion shopping.
- Mr. Scannell reviewed the May 2, 1996 SDCERS Board Minutes (Exhibit 10), which show (page 2) that Mr. McGrory stated it was difficult for the City to work with the system's fluctuating rates. Mr. Scannell could not recall any discussions regarding that topic. Although the minutes reflect that John Casey questioned why Mr. Wyatt, of Morrison & Foerster, was not being sought to give an opinion (page 3), Mr. Scannell could not recall having any conversations regarding that topic.
- Mr. Scannell was presented with the June 11, 1996 SDCERS Board Minutes (Exhibit 11), but he could not recall anything regarding that meeting.
- Mr. Scannell reviewed a memorandum from Lawrence Grissom to the Business and Procedures Committee, dated April 8, 1999 (Exhibit 12). Ms. Blaskey asked Mr. Scannell if he recalled whether in 1999 a meet and confer was scheduled to be held. Mr. Scannell stated that he did not. Ms. Blaskey also asked whether he recalled an issue arising regarding the City's contributions. Mr. Scannell stated that he did not.

When Ms. Blaskey asked Mr. Scannell what his current view of the pension problems was, he responded that he thought that MP-2 granted enhanced benefits for individuals who voted to approve the proposal and that may be against the law. He stated that he does not know too much about that proposal, but he felt it was inappropriate because MP-1 put a floor in place and it should not have been altered. When asked whether he had any concerns regarding MP-1 today, Mr. Scannell stated that MP-1 was the genesis of all of the pension issues. While Mr. Scannell did not explicitly discuss why he felt that MP-1 was the genesis of all of the pension issues, he seemed to be referring to how MP-1 introduced the concept of the trigger.

Contact with Other City Employees

Mr. Scannell did not have any contact with Financial Services or the City Manger, except that Jack McGrory would occasionally attend SDCERS Board meetings if an especially important issue was going to be discussed. Mr. Scannell did not have any contact with the City Council, except that he asked Mayor Golding to reappoint him and he did win her vote.

At some point, Mr. Scannell recalled an issue arising regarding Lorraine Chapin because she was wearing "dual hats" and it seemed that she had conflicted loyalties. He could not recall anything more about his concern or why had it. Mr. Scannell recalled that he, along with Keith Enerson, approached Jeff Witt of the City Attorney's Office at some point regarding advice about conflicts of interests generally. He could not recall what specific issue prompted the visit, but it may have been his concern that Ms. Chapin had a conflict. He recalled that Mr. Witt assured them that situations present themselves "all the time" in which individuals within the City must wear dual hats. Mr. Witt explained that, for example, the Attorney General could prosecute the State even though he was also an employee of the State. Mr. Scannell could not recall if this issue was ever resolved, but he stated that he was not very concerned with the issue during his tenure.

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